RESIDENT REPRESENTATIVE OFFICE OF THE
INTERNATIONAL MONETARY FUND
1, Knyaz Alexander I Square, BNB
Sofia, Bulgaria
Tel. [359 2] 981 4506
Fax [359 2] 981 2524

PRESS RELEASE:

Statement at the end of an IMF Mission to Bulgaria

October 4, 2010

An IMF mission led by Catriona Purfield visited Sofia from September 23 to October 4 to discuss recent economic developments with the authorities. At the end of the visit, Ms. Purfield made the following statement:

"As the global economy exits its deepest post-war recession, Bulgaria is benefiting from stronger exports and the economy is poised to stage a gradual recovery. In 2010, real GDP growth is projected to range between 0 and 0.4 percent, an update relative to the October World Economic Outlook that reflects a July 2010 forecast.[1] The current account deficit is expected to decline to just below 3 percent of GDP and inflation will remain moderate.

"In 2011, the recovery should gain traction. Real GDP growth is forecast to rise to 2–2½ percent (year-on-year) as the recovery broadens to encompass domestic demand. While this is projected to maintain the current account deficit to just above 3 percent of GDP, it is more than covered by foreign direct investments. Employment conditions may improve as growth increases.

"Bulgaria's prudent macroeconomic framework, anchored on the currency board, has been crucial in preserving stability through the global economic crisis. The substantial buffers accumulated in the fiscal and financial sectors during the boom provided important cushions through the downturn. As the economy recovers, attention now should turn to fiscal consolidation and sustaining a strong banking system to realize the long-standing policy objective of ERM II membership and eventual euro adoption.

"Strong policies have kept the 2010 budget on–track despite weak revenues. Several measures were taken to contain the cash deficit to 2¼ percent of GDP by end-August, including steps to bolster tax administration, streamline public employment, postpone special pension increases, and strictly control spending. However, recouping the shortfall in tax collections seen through August by the year-end will be challenging and shortfalls may occur. Safeguarding the 2010 deficit target will therefore require continued strict spending control with efforts focused on the curtailment of new obligations to avoid the risk of new arrears.

---

[1] The World Economic Outlook to be published on October 6 preceded the findings of this mission and the revisions of the GDP data by the National Statistics Institute.

“The 2011 budget rightly envisages the continued adjustment of spending to the lower revenues that prevail in the post-boom era. Despite the recovery, higher fuel excises and new tax compliance measures, 2011 tax revenues are budgeted to be some 4½ percentage points of GDP below their 2008 peak. It is therefore appropriate to continue the process of expenditure adjustment that began in 2010. However, if revenues do not quickly improve in 2010 and beyond, additional savings of about 1 percent of GDP could be needed to achieve the authorities’ deficit target (2½ percent of GDP). Announcing a set of contingency measures would have a high payoff in enhancing both budget transparency and predictability.

“Sustaining the adjustment momentum and improving efficiency will require bolder and more permanent expenditure reforms, including addressing the large deficit in the pension system. Successive reductions in social security contribution rates and ad hoc pension increases have caused a deficit in the social security system that requires about 6 of GDP in transfers from the central government. The proposed increase in the minimum service requirement is an important first step, but re-establishing balance in the pension system will require a comprehensive reform, including of funding and entitlements.

“The medium-term fiscal program foresees an ambitious reduction in the deficit to comply with commitments under the European Commission’s Excessive Deficit Procedure (EDP). Achieving the 2011 target and diversifying financing sources will help anchor expectations and rebuild the fiscal reserve. Once Bulgaria exits the EDP, a more gradual deficit reduction towards the medium-term goal of structural budget surplus could be considered to facilitate higher EU co-financing, subject to the important proviso that such resources ensure more effective absorption of EU-funded projects. A robust medium-term expenditure framework, rooted in detailed reforms, that is complemented by a fiscal rule that generates ample fiscal buffers to counter future shocks would lend predictability to the adjustment and ensure fiscal policy remains supportive of the currency board arrangement.

“Bulgarian banks have weathered the financial crisis well. The reported system-wide capital adequacy ratio at end-June 2010 was 18 percent, which is well above the regulatory minimum of 12 percent. As can be expected, impaired assets have risen with the downturn. However, system-wide buffers seem adequate even after the new Basel III requirements.”

See http://www.imf.org/external/country/BGR/index.htm for details on the continued dialog between the Bulgarian authorities and the IMF.